NOTES

WASHINGTON NOTES

OPEN MARKET OPERATIONS AT FEDERAL RESERVE BANKS

One of the most important steps yet taken by the Federal Reserve Board was determined and announced in a letter of October 8, issued to federal reserve agents throughout the country. In this, the Board authorized the reserve banks to begin, at their discretion, operations under sec. 14 of the act, which provides for the undertaking of open market operations. The section in question permits federal reserve banks, subject to rules and regulations prescribed by the Board, to "purchase and sell in the open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations, or individuals, cable transfers and bankers' acceptances and bills of exchange of the kinds and maturities by this act made eligible for rediscount, with or without the indorsement of a member bank." The Board had already issued regulations covering the purchase in the open market of bankers' acceptances, of United States government bonds, and of municipal warrants, but it had not yet issued regulations relating to "cable transfers" or to the purchase of "bills of exchange of the kinds and maturities by this act made eligible for rediscount." The original bill for the establishment of federal reserve banks, etc., permitted the purchase in the open market of "notes, drafts, and bills of exchange," but in the law as finally enacted, the words "notes and drafts" were stricken out in sec. 14, although they are retained in sec. 13 which relates to discount operations for member banks. The Board has now reached the conclusion, in which it is sustained by opinion of counsel, that Congress beyond question drew a distinction in secs. 13 and 14 of the Federal Reserve act between the several forms of commercial paper, and that promissory notes, even though bearing an additional indorsement, must be regarded as excluded from open market purchases under sec. 14. There remained then, as eligible for purchases under this section, "cable transfers," and "bills of exchange" of two kinds: (1) so-called foreign bills of exchange and (2) domestic bills of exchange (other than bankers' acceptances) drawn by one person on another, as by a seller of goods upon the purchaser, such as have been classified by the Board as "trade acceptances," either accepted or not accepted at the time of purchase.

In view of the abnormal conditions prevailing in Europe, the Board takes the view that the banks should be more than usually cautious in any foreign exchange operations entered into at this time. As to open market dealings in "domestic bills," the Board suggests that, although the special rate authorized may prove in the future a helpful factor in developing the freer use of this kind of paper, the supply of desirable paper is still very limited, and that there are also other objections that may be urged against open market operations in "domestic bills" at this time. However, the Federal Reserve Board recognizes that the reserve banks have the right to engage in open market operations in bills of exchange and that the decision whether the federal reserve banks should engage in such open market transactions rests entirely with them severally, and not with the Board itself. Should the transactions engaged in by any bank assume very large proportions, or develop along lines which would make regulation appear desirable, the Federal Reserve Board reserves its right at any time to regulate such transactions. At present the Board has left each federal reserve bank free to exercise the authority granted under sec. 14, without governing or restricting regulations, it being understood that any such bank desiring to establish an open market rate for domestic, "bills of exchange . . . . by this act made eligible for rediscount," will submit such rate to the Board for approval and determination, in the customary way.

The opinion of counsel upon which the Board has acted in this matter takes with reference to sec. 14 the position that:

> The legal effect of this provision seems clearly to be to vest in the federal reserve bank the right to exercise this power and to vest in the Federal Reserve Board only the power to regulate its exercise. In other words, Congress did not intend to vest a discretion in the Board to determine whether federal reserve banks should purchase and sell cable transfers, acceptances, and bills of exchange, but merely to regulate their purchase and sale. . . .
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> Inasmuch, therefore, as the power to purchase and sell cable transfers, acceptances, and bills of exchange in the open market is vested in the federal reserve banks subject only to rules and regulations of the Federal Reserve Board, it would seem to be the function of the Board either to prescribe the rules and regulations referred to, or, should the Board determine not to make such rules and regulations at this time, to inform the federal reserve banks that these powers may be exercised within the limitations of sec. 14, until further restricted by such rules and regulations as the Board may adopt.

A definite step has likewise been taken with reference to the foreign exchange operations of federal reserve banks—a branch of their activity

which has thus far been held in abeyance on account of the disturbed conditions existing in foreign countries. The subject was brought prominently forward about the beginning of September by the action of Secretary of the Treasury McAdoo, who recommended to the President that the first step in developing the foreign operations of reserve banks be taken by placing foreign agencies in some of the principal cities of South America. In speaking of this Mr. McAdoo said:

This plan [a proposal to establish joint agencies representing groups of national banks], even if it were not open to objection, would be manifestly inferior to the agency of the combined federal reserve banks. The federal reserve banks comprise in their membership every national bank in the United States, as well as a number of our leading state banks and trust companies. They constitute a financial organization of unequaled strength, and their operations in foreign countries will be for the common benefit of all of the national banks, state banks, and trust companies composing the federal reserve system. These agencies in foreign countries could, in addition to their banking business, render a great service to American business men and bankers by furnishing credit reports and general information about trade and finance in the various countries in which they operate.

President Wilson in a letter to the Secretary of the Treasury approved this general idea of foreign agencies in South America. The subject was taken up by the Federal Reserve Board for investigation, and on October 12 the definite announcement already referred to was made as to the position of the Board with reference to foreign operations of the banks for the future. This position, briefly, is that foreign agencies should be established primarily for the sake of protecting the gold monetary stock of the United States and that their operations should be designed to effectuate that end as far as possible. Moreover, it is held that the establishment of agencies should be deferred pending the development of more settled conditions abroad, while the final work of opening foreign banking fields should be left to individual members of the system.

These views are expressed in a committe report filed with the Board at the time of the announcement in question. The report in question defends the view that federal reserve banks—being the custodians of the reserve money of the member banks—should not be permitted to do pioneer work in Latin-American countries, granting credit facilities which would lead to a lockup of reserve money in loans which, in most cases, would be subject to wide fluctuations of foreign exchange. Secretary of the Treasury McAdoo at the same time stated that his recom-

mendations about joint agencies for federal reserve banks did not contemplate this character of operation.

The report reminded the Board of the policy habitually pursued by the large government banks of Europe which do not go into foreign fields except to acquire, as secondary reserves, foreign bills on the most important European countries where large discount markets exist and where the gold standard is established beyond question. In those countries, these government banks maintain correspondents, and the committee believes that, when normal conditions shall have been restored in Europe, joint agencies or correspondents could be used to good advantage there. The committee also calls attention to the fact that England, Germany, and France have established independent banks or branch banks of deposit banks in Latin-American countries to do pioneer work, and that the United States should pursue the same course, inasmuch as it is necessary for banks going into this field to have the widest possible range of activity in order to be able to compete with the local banks and the branches of the foreign banks already established in these fields. Federal reserve banks, being properly restricted to certain transactions such as may not interfere with the absolute liquidity of their condition, could not compete successfully in this respect, whereas it should be their function to do all in their power to assist American banks which enter the Latin-American field.

The committee report favored, and the Board and Secretary McAdoo concurred in suggesting, an amendment of the Federal Reserve act which would enable American member banks to co-operate for the purpose of jointly owning and operating foreign banks. The contribution of the federal reserve banks in this development in Latin-America would primarily consist in providing conditions so favorable for American bank acceptances that the American banks willing to offer credit facilities there will be materially assisted in meeting the European rates which, at the present time and probably for some time to come, will compare unfavorably with American discount rates.

Wherever the federal reserve banks can help in the development of American banking by establishing direct connections in Latin-American countries for the purpose of facilitating discount operations of this kind, it will be, in the opinion of the committee, their proper function to do so.

PROPOSED SOURCES OF REVENUE

The Secretary of the Treasury, in reply to many inquiries about the revenue measures that will be proposed in the next Congress, has determined to recommend (1) that the emergency revenue act which expires

by limitation on December 31, 1915, be extended until peace is restored in Europe, and (2) that the existing duties on sugar shall be retained for several years, or until normal customs conditions are restored. These are said to be distinctively revenue measures and are necessary in view of the extraordinary conditions now prevailing throughout the world. In making the announcement the Secretary says:

It is impossible to state at the moment what, if any, additional revenue measures may be necessary, as the estimates of the various departments have not yet been received. It is clear, however, that the two sources of revenue I have just mentioned should be preserved, no matter what the departmental estimates may be. Of course it rests with Congress to say what shall be done. I am merely stating what my recommendations in these particulars will be.

The action thus taken is of large importance from many standpoints. It reverses the conclusions arrived at as the result of one of the sharpest controversies during the discussion of the Underwood Tariff bill—that relating to the sugar schedule. At present the tariff on sugar is 0.71 cents per pound for sugar testing not over 75 degrees polariscope test, 0.026 cents per pound for every additional degree of fineness. The plus revenue from this rate of duty on the present basis of importation varies from $35,000,000 to $50,000,000 per annum. Under the tariff law, as it stands, sugar would have become absolutely free from and after May 1, 1916. The reduction of the tariff from about 1.60 cents per pound under the Payne-Aldrich tariff has not produced much effect upon the sugar industry thus far, mainly owing to the abnormal conditions produced by the European war. The action now announced has apparently little relation to the protective controversy, but is primarily due to considerations of revenue. As is well known, the Treasury is now running behind at the rate of $8,000,000 to $10,000,000 per month, and a further dropping of revenue sources would necessitate the finding of corresponding new sources with as little delay as possible. As it stands the announced intention to retain the sugar duty is of very great political importance, because under existing parliamentary regulations it will open the way to a general tariff discussion in Congress if opponents desire to insist upon such a controversy. Present indications are that such a debate of greater or less intensity and bitterness will result from an effort to amend the tariff.

NEW FORM OF TREASURY STATEMENT

The daily statement of the United States Treasury and the monthly public debt statement of the government have been revised, so as to make them more intelligible and clearer to the public. The new daily

statement will represent the actual condition of the Treasury, so far as it is possible to present it, at the close of business each day. The new public debt statement will show the actual condition of the Treasury and the state of the public debt at the close of business each month. The new form for the daily Treasury statement became effective October 1, 1915, and that for the public debt statement, October 31, 1915.

The most important points in which the new form of daily statement differs from the old are the following:

The assets and liabilities of the government have heretofore been published under two general classifications, viz.: (1) "The General Fund" and (2) "The Currency Trust Funds," "The General Fund," and "The Gold Reserve Fund." The new form shows the assets and liabilities divided into three general classes, viz.: (1) "Gold," (2) "Silver Dollars," and (3) "The General Fund." This gives at a glance the amount of gold and the amount of silver dollars in the Treasury, the liabilities against such coin and bullion, and the actual condition of the general fund.

In the new form the item "Disbursing Officers' Balances" is excluded from the liability side of the general fund and included in the net balance. These disbursing officers' balances consist of amounts placed by the Secretary of the Treasury to the credit of disbursing officers, against which they are authorized to draw checks in payment of public obligations. These amounts are funds of the United States in the same sense that the balance remaining, subject to the warrant of the Secretary alone, is money of the United States. In the past, whenever the Secretary has placed an amount to the credit of a disbursing officer, it has been the custom to carry that on the Treasury statement as a disbursement. As a matter of fact, the money in many instances is not spent for months, and sometimes not at all, being returned to the Secretary's account. Funds are placed to the credit of disbursing officers practically as a bookkeeping arrangement, and they are as much a part of the working balance of the Treasury as the money which is subject to the warrant of the Secretary. As the net balance should represent the funds in the Treasury available for paying the current obligations of the government, the amount placed on the books to the credit of disbursing officers should be included therein.

The amount deposited by national banks for the retirement of national bank notes, but not yet paid out for that purpose, is also included in the net balance. In the old statement this amount was carried on the liability side of the general fund. This was an error, because by law deposits for the retirement of national bank notes are a part of the public

debt. The act of July 14, 1890, prescribes that such deposits shall be covered into the Treasury as miscellaneous receipts, and that the notes thus rendered subject to retirement by the United States shall be carried as a part of the public debt. This fund is not the 5 per cent fund provided for the redemption of the current circulation of national banks, but is a fund for the redemption of the notes of national banks which have ceased to circulate notes, or which have reduced their circulation. As directed by the act of July 14, 1890, the amount to the credit of this fund was placed in the general fund balance, where it was carried continuously until the early part of 1913, when the form of daily Treasury statement was changed. The item is now restored to the general fund balance, where it belongs, and will appear as a liability on what was previously known as the monthly public debt statement.

Following the general fund statement appears the daily trial balance of the general fund, entitled "Receipts and Disbursements This Day." This is a simple statement of the day's transactions. One important change contained in this table, as well as in the "Comparative Analysis of Receipts and Disbursements" on p. 2, is the segregation of Panama Canal receipts.

In the past it has been customary to set forth Panama Canal disbursements separately as extraordinary expenditures, but receipts from tolls, profits from the sales of material on account of the Canal, etc., have been included in the ordinary miscellaneous receipts. In the future these Panama Canal receipts, like the disbursements on account of the Panama Canal, will appear separately.

The new daily statement is on a cash basis. Receipts have formerly been reported on a cash basis, while disbursements have been on a mixed basis. This has proved confusing. Under the new form, disbursements, like receipts, represent cash transactions.

It will be impossible to state outstanding checks in the column of liabilities in the daily statement, because it is not practicable to get the information daily from disbursing officers. Outstanding checks and warrants are offset in large measure, however, by receipts which are in transit to the Treasury. All outstanding warrants and checks will be shown monthly in what previously was known as the public debt statement.

Several tables that appeared on the fourth page of the old statement are either omitted entirely as unimportant or uninforming, or are included in the new items on p. 3—"Federal Reserve Notes and National Bank Notes Outstanding" and "Transactions Affecting Federal Reserve and National Bank-Note Circulation." "Bonds Held in Trust for

National Banks" still appears, but the table of "Pay Warrants Drawn" has been omitted. It is believed that a daily statement of these warrants is of no value, and it will hereafter appear in the form of "Pay Warrants Issued," monthly, in what previously was known as the public debt statement.

The new statement will give an accurate idea of the actual condition of the Treasury as far as it is ascertainable from day to day. The old statement, with its cumbersome notations of purely bookkeeping transactions within the Treasury Department, which had little bearing upon actual expenditures, has been very confusing and has led to much misconception as to the actual condition of the Treasury.

The public debt statement in the new form is changed to "Financial Statement of the United States Government."

Instead of reproducing the daily statement for the last day of each month on the public debt statement, the new statement will include a table of cash available to pay maturing obligations, or, in other words, the working balance of the Treasury with the liabilities against it. On the asset side of this table will be the net balance in the Treasury. On the liability side of this statement will be set up outstanding warrants, checks, and matured coupons. While it will not be practicable, as stated above, to get daily from disbursing officers a statement of their outstanding checks, it will be possible to get this information once a month.

The monthly statement will also include a table of warrants and checks issued by departments which will show the expenditures according to this classification.

It will be necessary to get information from disbursing officers all over the country for the monthly statement, but it is believed that this work can be so expedited that the department will be able to issue the statement on the 15th of each month.

GROWTH OF THE "TRADE BALANCE"

The current figures relating to American export trade furnish the best explanation of the reasons for the unprecedented action of the French and English governments in floating a loan in the American market. Figures for the eight months ending with August, just issued by the Department of Commerce, afford a fair comparison with the corresponding period of 1914, inasmuch as exportation had not begun to be seriously hampered until toward the end of August, 1914, "manifests" and other documents being filed at the various ports and the cargoes awaiting shipment until vessels were willing to leave harbor.

The accompanying condensed table shows the comparative situation for the period in question.

TABLE I

Groups	Month of August, 1915		Eight Months Ended August, 1915	
	1914	1915	1914	1915
Imports	(000 omitted)	(000 omitted)	(000 omitted)	(000 omitted)
Crude materials for use in manufacturing	$40,751	$53,464	$ 436,234	$435,468
Foodstuffs in crude condition and food animals	16,813	18,192	159,110	147,181
Foodstuffs partly or wholly manufactured	23,121	21,755	181,199	205,467
Manufactures for further use in manufacturing	19,030	23,069	198,584	163,817
Manufactures ready for consumption	28,635	24,668	284,496	191,086
Miscellaneous	1,426	679	10,735	7,863
Total imports	$129,767	$141,830	$1,270,361	$1,150,884
Exports				
Crude materials for use in manufacturing	$12,237	23,890	340,514	375,085
Foodstuffs in crude condition and food animals	28,610	25,878	108,805	289,317
Foodstuffs partly or wholly manufactured	18,596	42,181	170,685	405,012
Manufactures for further use in manufacturing	16,208	40,712	240,692	285,737
Manufactures ready for consumption	32,357	113,189	421,912	753,352
Miscellaneous	187	11,213	4,263	86,060
Total domestic exports	$108,198	$257,065	$1,286,874	$2,194,566
Foreign merchandise exported	2,169	3,905	24,475	37,187
Total exports	$110,367	$260,971	$1,311,349	$2,231,754

It will be observed that up to the end of August, 1915, the total exports of all classes of merchandise (including re-exports of foreign) totaled $2,231,754,730, as against imports of $1,150,884,760. It is thus a notable fact that recovery in importations has now reached a point where the total is only about $120,000,000 behind last year's figures, which were $1,270,361,263. While, as already observed, it is true that the eight months of 1914 on which this comparison is based included one "war month"—August, 1914—so that the last year's returns do not stand for normal conditions, it is also true that the recovery in imports is distinctly progressing, although the character of the goods has changed.

The other notable fact to be observed in the gross figures is that while exports and imports for the eight months of 1914 were nearly equal, exports being only about $41,000,000 in excess, this year's exports are nearly $1,100,000,000 ahead of this year's imports and over $900,000,000 ahead of last year's exports for the same period. The great trade balance of eleven hundred millions averages over $135,000,000 per month since the beginning of the year, and the sales are proceeding at very much the same rate today. At this rate the balance would be, by the end of the calendar year, between $1,600,000,000 and $1,700,000,000 for the twelve months.

The change in the character of our foreign business, indicated by the new figures, is regarded as even more interesting than the mere rate of growth. Last year during the corresponding period the largest single group of imports in the government classification was crude materials for manufacturing, which was about $436,000,000, while the second largest was manufactures ready for consumption, which was $285,000,000. This year the crude materials imported are almost the same in value as last year, but manufactures are nearly $100,000,000 less, being only $191,086,827. At the same time, manufactures ready for consumption exported have increased from $422,000,000 last year to $753,000,000 this year. The materials imported are, in fact, about the same, but the nation has greatly reduced its foreign purchases of manufactures ready for use and immensely increased the proportion of its foreign sales of such manufactures. It bought about the same quantity of crude foodstuffs this year as last, and increased its purchases of manufactured foods only relatively slightly, but it nearly trebled its sales of crude foodstuffs and more than doubled its sales of manufactured foods. As sales of materials for further manufacture to other countries were not far from the same this year as last, it is plain that the country has become more and more self-contained, supplying its own needs, and at the same time has greatly strengthened itself as a purveyor of manufactured goods to other nations. The basic figures for foreign trade thus supplied indicate immensely greater growth in the volume of domestic manufacturing for domestic consumption and bear out very amply the current reports from all quarters regarding the renewal of activity in production. The tendencies thus indicated are for the most part even more marked in their relative importance when attention is confined to the monthly returns. Crude foodstuffs exported during August were less than during August, 1914, while manufactures ready for consumption were about three and one-half times as great in value as in August, 1914.